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SUBJECT: SOME DIET ECONOMIC GOALS ACHIEVED DESPITE  
POLITICAL DIFFICULTIES

REF: A. REF A: 2006 TOKYO 3290

[1](#)B. REF B: 2005 TOKYO 5709

[1](#)1. (SBU) Summary. Prime Minister Koizumi christened the 164th Diet session the "administrative reform" Diet, a fitting moniker in terms of legislative achievement. He refused to extend the Diet past June 18, leaving behind much unfinished business such as Constitutional and educational reform (see Septel), but his legislation to reform the government's administration was passed after lengthy negotiation. For a discussion of administration reform and tax reform see paragraphs 2-5. Bills involving health care are discussed in paragraphs 6 and 7. The Financial Instruments and Exchange Law can be found in paragraphs 8-10 while agricultural reforms are handled in paragraphs 11-12. The revision to the Town Planning Laws is described in paragraph 13 (and Reftel A) and an examination of employment laws affecting women and youth begins in paragraph 14. Additional bills, agreements, and treaties are examined in paragraphs 15-23. End summary.

Administrative reform  
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[1](#)2. (SBU) After 128 hours of deliberations in both houses, the Diet finally passed the administrative reform bill, which provides a framework to realize a "simplified and efficient government". Although intended to set in motion a program for continued reform after Koizumi's departure, the actual details will have to be worked out with subsequent implementation bills to be discussed in the fall or during next year's Diet sessions, at which time bureaucracies affected by the downsizing may fight back. The bill also establishes the Headquarters for Administrative Reform, made up of Cabinet members and headed by the Prime Minister.

[1](#)3. (SBU) Specific policy measures adopted by this bill are:  
(a) review of independent administrative institutions and other government-affiliated corporate entities; (b) streamlining of special accounts by decreasing the number to half or one-third from the existing 31 accounts within five years. (In terms of amount, however, it only affects 12 trillion yen out of the Special Accounts' total 225 trillion yen.) (c) trimming of the central and local government work force by 5 percent and 4.6 percent respectively over the next five years (FY06-10) through attrition and retirement, outsourcing practices to private entities and reducing the number of unnecessary practices; (d) reducing government assets to half of that of FY2005 in terms of GDP percentage; (e) consolidating or privatizing eight government-affiliated

financial entities, i.e., merging five institutions -- the Japan Finance Corporation for Small and Medium Enterprise, the National Life Finance Corp., Okinawa Development Finance Corporation, the Agriculture, Forestry and Fisheries Finance Corporation and the section offering international banking services at the Japan Bank of International Cooperation (JBIC) -- into a single entity. The Development Bank of Japan and Shoko Chukin Bank will be fully privatized in five to seven years. The overseas yen loan aid operations at JBIC will be transferred to the Japan International Cooperation Agency by April 2008. The merger of JIBC yen loan program into JICA is part of the larger ODA (official development assistance) reform, being undertaken by the Ministry of Foreign Affairs. The Koizumi administration intended to produce a major consolidation of government financial institutions but critics claim this move may have only shuffled agencies around with little downsizing of government institutions.

#### Tax Change Legislation for 2006

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14. (SBU) The Diet approved this year's tax reform legislation on March 27. The tax bill is estimated to result in a 2.4 trillion (0.5 percent of GDP) increase in central and local tax revenues once the tax measures are fully in place. Highlights include eliminating the remaining half of the 3.3 trillion special fixed-rate individual income tax cuts starting in January 2007. (Half of the special tax cuts were eliminated from January 2006.) This is an incremental increase in the tax rate but with the economy doing better we do not expect it to have a negative impact on growth.

15. (SBU) Other tax changes include (a) scaling back tax

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incentive programs for corporate investment in IT and R&D; (b) scaling back earlier reductions in taxes on real estate transactions, such as the property acquisition tax, and the registration and license tax; (c) simplifying the liquor tax system by reclassifying ten categories of alcoholic beverages to four, including an increase in the wine tax by 6.9 to 57.6 per 720-ml bottle, and a lowering of the sake tax by 14.8 to 86.4 per 720-ml bottle, effective May 2006; (d) raising the tobacco tax on cigarettes by 0.85 to about 8 per cigarette, effective July 2006; (e) modifying the qualification for non-permanent resident tax status. From 2006, anyone living in Japan for any 5 out of any 10 consecutive years will not qualify for non-permanent resident tax status. In particular, the increase in the wine tax is somewhat worrisome because it may represent only the first of many tax increases on US exports of wine.

#### Health Care Reform

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16. (SBU) Health care reform bills passed on June 14 will increase co-payments for well-off seniors age 70 and over, decrease co-payments for children, and give private non-profit hospitals greater flexibility to supplement revenues, including through issuance of hospital bonds. Liberal Democratic Party (LDP) lawmakers reportedly are already discussing additional new measures to reduce government health care spending, however, in response to criticism that these bills passed with inadequate debate and do not go far enough to address waste in Japan's health care system. Measures under consideration by the LDP reportedly include significant new cuts in reimbursement prices for pharmaceuticals and a move from biannual to annual price cuts, changes that will exacerbate downward price pressures on domestic and foreign pharmaceutical manufacturers. Also reportedly under consideration are measures to expand the use of a "fee-for-diagnosis" reimbursement model, in which hospitals are reimbursed at a flat rate determined by the type of illness, rather than the current "fee-for-service" model, which gives health care providers an incentive to

maximize billable services to patients, including frequent visits to the doctor and prolonged hospital stays. How the LDP discussions play out will give some indication of the extent to which the conservative Japan Medical Association is able to regain its traditionally strong influence with LDP politicians during the upcoming transition to a new LDP leader.

¶17. (SBU) Separately, the Diet revised the Pharmaceuticals Law June 8 to permit over the counter retail sale of less risky non-prescription drugs, subject to licensing at the prefectural level. These changes are expected to pave the way for convenience stores and other retailers to sell all but the highest risk non-prescription medicines, including treatments for common ailments such as colds, headaches etc. The revised law does not permit Internet or mail order sales, however.

#### Financial Instruments and Exchange Law

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¶18. (SBU) On June 7 the Diet passed the Financial Instruments and Exchange Law. This law, which amends and renames the former "Securities and Exchange Law," provides a wide-ranging legal framework designed to enhance consumer protections and establish uniform rules for transactions involving financial products and services.

¶19. (SBU) The four basic goals of the law are: (a) to establish a cross-sectoral regulatory framework of financial products and services by providing a definition of collective investment scheme and derivatives; (b) to enhance disclosure requirements by introducing a statutory quarterly reporting system for listed firms, enhancing regulations on internal control for financial reporting with a mandatory certification by management, and improving the transparency of the Tender Offer Bid (TOB) process; (c) to strengthen penalties for illegal transactions by increasing the maximum criminal penalties against such frauds as false financial reports and market manipulation to 10 years in prison from the present five years; and (d) to permit stock exchanges to create self-regulatory committees to make exchanges more transparent and reliable. The law is expected to take effect by summer 2007.

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¶10. (SBU) The new Financial Instruments and Exchange Law has drawn much attention in the wake of the June 5 arrest of maverick investor Yoshiaki Murakami on charges of insider trading related to the 2005 Livedoor-Nippon Broadcasting hostile takeover attempt. The new law closes loopholes used by Murakami and former Livedoor CEO Takafumi Horie to acquire major ownership positions in target firms without filing a formal TOB. At the same time, the new law revises TOB rules to increase the transparency of the process by requiring target company boards to take a formal position on tender offers and communicate their views to shareholders. Furthermore, it permits buyers to withdraw or revise their offers in response to target companies' deployment of takeover defense measures such as stock splits or poison pills. The new law also tightens the deadline for institutional investors to report the acquisition of more than five percent of a given company's stock, from 90 days to two weeks, and it requires fund managers to register and report their names and addresses. These two changes could potentially interfere with legitimate investment strategies and inhibiting the development of Japan's investment fund market.

#### Agricultural Reform

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¶11. (SBU) A farm bill ostensibly designed to promote agriculture reform passed the Diet on June 14th. When it goes into effect in 2007, the government will focus direct

payment subsidies on large-scale farmers or farmer organizations in an effort to promote consolidation and increased agricultural productivity. GOJ authorities, claiming the new supports will be more consistent with WTO rules, hurriedly passed the bills in part to prepare Japan for the now-stalled Doha negotiations. Some observers with whom we have discussed the bills are not optimistic that they will prove effective in promoting reform in Japan's lackluster agriculture sector, however since local governments can exploit loopholes to funnel subsidies to smaller farmers despite the goal of focusing on larger, competitive farms.

¶12. (SBU) Two bills related to BSE and submitted by the opposition Democratic Party of Japan (DPJ) will be carried over to the next Diet session, but it is unlikely they will ever be passed by the LDP-controlled Diet. The bills are designed to provide consumers with more information on the beef they are purchasing, in particular where and when it was imported. In addition, importers would be obliged to keep a register of the name of the exporting country, code identifying the cattle of origin, the party responsible for the code and the date of import. Distributors of imported beef would either place this information on the packages of beef or display it in their stores. The bill also mandates that the government evaluate BSE risk in countries or regions that have experienced a BSE problem.

#### Town Planning Laws (Machizukuri Sanpo)

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¶13. (SBU) Newly-passed amendments to Japan's Three Town Planning Laws -- comprised of the City Planning Law, the Large-scale Retail Store Location Law, and the Urban Center Revitalization Law -- will make it more difficult for retailers to open stores of over 10,000 square meters. This will be achieved by reducing the types of land available to retailers hoping to build large stores from six zones to only three -- commercial districts, neighborhood commercial districts, and quasi-industrial districts -- and prohibit retailers from building such stores on unzoned and agricultural land, which they are currently allowed to do. The Japanese retail sector believes the amended laws will not achieve their objective of attracting retailers back to depressed urban shopping areas, but will instead result in fewer, and smaller, shopping options in suburban areas. The laws will not go into effect until December 2007, but prefectures and local governments around Japan have already used their impending enactment as an excuse to introduce further restrictions on large retailers and reject large-scale retail store applications. The Embassy is engaging the GOJ to ensure that the Laws' implementing regulations and the process leading up to them will be implemented transparently and fairly and include

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opportunities for the USG and private sector to provide input. (For further information please see Reftel A.)

#### Employment Practices

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¶14. (SBU) The Diet passed an MHLW-drafted bill to expand employment opportunities for women and youth on June 15, only a day before the Diet session effectively came to a close and only after heated debate between the ruling and opposition parties finally resulted in a compromise. The measure was prompted by concerns over the declining workforce -- a government census confirmed that Japan's total population decreased in 2005 for the first time since the end of WWII. Known as the Equal Employment Opportunity Bill, the legislation is designed to reduce gender discrimination. One goal was to create a ministerial order to prohibit implicit gender discriminations such as recruiting based on height and weight, basing promotion decisions on willingness to accept transfers to other parts of the country -- even when an

assignment does not require it -- or basing promotion on the number of different locations where an employee has worked (female workers tend to stay in one place during their career, making them vulnerable to this type of discrimination). Labor unions argued that other implicit gender discrimination existed as well and successfully convinced the Diet to add a supplementary resolution (futai ketsugi), which states that any discrimination not included in the ministerial order could be defined as illegal through judicial rulings. The government hopes this legislation will encourage more female workers to join the labor pool.

¶15. (SBU) The Diet also passed the Human Resource Development and Employment Management Amendment Bill. It is designed to give practical, effective vocational training to youths through a new system combining on-the-job training with lectures. The government hopes this new system will encourage retiring baby boomers to transfer their technical skills and know-how to young people.

#### Market Testing Law

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¶16. (SBU) The Bill for the Reform of Public Services through the Introduction of Competition, known as the "Market Testing Law", establishes a legal framework and lays out the procedure for allowing the private sector to bid competitively with the public sector to provide public services on national and, on a voluntary-basis, local levels.

An independent, third party organization made up of lawyers and accountants is to be set up to ensure transparency, neutrality and fairness in the process. The Prime Minister's Council on the Promotion of Regulatory Reform has championed this legislation as a way to reduce the size of government by outsourcing government services and has visited the United States and Europe to gather ideas on possible outsourcing options. In addition, the impact of this bill already has been felt. On June 1 the government outsourced the issuance of parking tickets to private firms. Another service that is a candidate for this initiative is the government "Hello Work" job placement services. (For more background on this bill see Reftel B.)

#### Customs Law

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¶17. (SBU) The Customs Tariff Law (kanzei teiritsu ho) Amendment Bill was passed on March 29 and went into enforcement on April 1. The Ministry of Finance (MOF) had hoped to broaden the reporting authority to allow prior notification by a broader range of authorized reporters in response to public comment in November 2006, but the bill that ultimately was submitted and passed requires duties only on aircraft and vessel captains.

#### Road Transportation Vehicle Law

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¶18. (SBU) The Road Transportation Vehicle Bill was passed on May 12, released to the public on May 19, and will become effective within 2.5 years. The revision to this law includes the ability to register new vehicles on-line. Other recommendations, such as removing owners' information from the original certificates of vehicle inspection, thus

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reducing the burden on auto leasing companies and other owners of large numbers of vehicles, were not included. The relevant Ministerial Ordinances are to be drafted by the end of 2006. The law still requires owners to complete the registration process within a 15 day time period, however, MLIT is now willing to accept en masse applications which would enable the re-registration to be done within six months. US stakeholders are fully involved in the outlining and drafting of the Ministerial Ordinances, and a study group began meeting on June 20. The US had been requesting this



step in the Regulatory Reform Initiative as a means to reduce the burden on auto leasing companies. GE is among the American companies that will benefit from this relaxation of regulations.

#### Anti-corruption Legislation

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¶19. (SBU) The Diet approved ratification of the United Nations Anti-Corruption Convention on June 2 but did not pass the legislation actually containing the ratification because the opposition DPJ raised objections to the government-drafted bill. The legislation, dubbed the "Conspiracy Bill", was drafted to combat organized crime. It also would have brought Japan into accordance with OECD anti-corruption guidelines because it included a provision to penalize Japanese nationals who commit bribery overseas. Originally submitted in 2004, the bill continues to be "under consideration," and will be carried over to the next Diet session.

#### Eliminating Tariffs on Multi-chip Integrated Circuits

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¶20. (SBU) Measures to implement the agreement to eliminate tariffs on multi-chip integrated circuits between the United States, EU, Korea, Taiwan and Japan, passed the Diet at the end of April with apparently little or no dissension. With the ratification of this agreement, the U.S., EU, and Korea will abolish their duties, and Japan will bind its applied rate at zero. Although it was hoped the treaty would spur zero-tariff sectoral agreements in WTO negotiations, this does not appear to have happened yet.

#### MRA on Telecommunications Equipment

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¶21. (SBU) U.S. and Japanese negotiators have not yet reached agreement on a final text for a Mutual Recognition Agreement (MRA) on Telecommunications Equipment. It is likely the agreement will not be ready for submission to the Diet until ¶2007.

#### Free Trade Agreements (FTAs)

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¶22. (SBU) As expected, Japan's "economic partnership agreement" (EPA) with Malaysia was ratified during this Diet session. Because of the ongoing political uncertainty in Thailand, however, the Thailand-Japan agreement remains unsigned and consequently has yet to be submitted for Diet approval even though the text of the agreement itself has been completed. Negotiations on the Japan-Philippines EPA continued without final resolution, thus preventing Diet action on that agreement as well.

#### Japan,s EEZ with China and South Korea

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¶23. (SBU) Three bills to crack down on Chinese and South Korean energy exploration within Japan,s exclusive economic zone (EEZ) will be taken up in the next Diet session. The bills were submitted by the LDP and the DPJ, respectively. The LDP,s bill restricts entry into an area 500 meters around a facility set up to exploit, develop, or explore natural resources inside the Japan-set EEZ median line. This bill is designed to protect oil drilling and other equipment from being damaged. The DPJ on the other hand submitted two bills. One deems that exploration for natural resources be carried out by the government and requires all exploration plans be subject to Cabinet approval. The other would prohibit foreign nationals or entities from carrying out such research within the same coastal area without government approval. The government will now have to continue

contentious negotiations with China and South Korea over the EEZ median line without domestic legislation allowing it to crack down on violators.

## Conclusion

¶24. (SBU) Overall, this was a lackluster session, perhaps not surprising given Koizumi's lame duck status. Koizumi achieved his main objective, however -- passing his administrative reform bill. In addition, the Diet began the difficult process of reforming the health care system and also made some progress toward deregulation with the Market Testing and Road Transportation Vehicle Laws. The attempt at agricultural reform was disappointing, however, as was the failed attempt at anti-corruption legislation. As for other bills, such as the Financial Instruments and Exchange Law and the Town Planning Law, we will continue to monitor and report on the impact on US interests.

SCHIEFFER